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Indexing

Abstracting

# CLAUSES OF CORPORATE SOCIAL RESPONSIBILITY IN THE INDONESIA NATIONAL LAW IN THE PERSPECTIVE OF INTERNATIONAL INVESTMENT AGREEMENT

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## Abstract

*This paper elaborated clauses of corporate social responsibility as government policy and its implication to the international investment agreement. It is also explore the main sets of ideas and the theoretical framework that form the basis of CSR as introduced in article 15 of Investment Law. The analysis exposes the role of social responsibility and environment management as an obligation in protecting the interest of the states; investors; peoples and comparing it with the Prohibition of Performance Requirement (PPR) as mostly introduced in international investment agreement, particularly in investment chapter under FTA.*

*Keywords: investment; agreement; CSR*

## INTRODUCTION

Clauses of Corporate Social Responsibility (CSR) as introduced in Investment Law has many implication to the International Investment Agreement, legal framework of international agreement involved entire government policy on investment. International investment agreement consist of bilateral, multilateral and International Investment Agreement IIAs. Legal basis of bilateral and multilateral investment agreement was very different since each has different purpose agreement. Bilateral agreement namely BITs, Bilateral Investment Treaty signed by government of Indonesia with more than 86 countries in the world; the objective of BITs made by two countries is to protect the interest of investors from the two states, while multilateral investment agreement mostly fall under the FTA (Free Trade Area) agreement and International Investment Agreement in principles define as agreement involving more than two states. Article 15 of the Investment Law requires foreign and domestic investors to engage in social responsibility, noncompliance with article 15 can lead to administrative sanctions. Debate among scholars commencing from definition of CSR, Carol and Buchholtz (2000, 35), offer definition of CSR, that encompasses the economic, legal, ethical and philanthropy expectations placed on organizations by society at given point in time (Hennigfeld et. al. 2006, 6). The CSR also relatively known as social phenomenon along with development of social interaction particularly among industrialist and business communities. The moral issues arising from industry and business activity has occupied of philosophers, scholar, writers, religious leaders and law makers for centuries (Zerk 2006, 15).

Recently, CSR (Corporate Social Responsibility) became an important topics issue. The discourses of CSR broadly discussed among the scholar, industrialist, economist, lawyers and others interested parties. The core of the debate has focused primarily on questions around and considered to be appropriate of the right or responsibilities of the government, businesses, peoples and stakeholder at large. The common theme implicitly in defining CSR is integration means that integration of economic, social, legal and philanthropy. As an independent and sovereign state, government has an obligation to protect the right of the nation and its peoples in various aspect of life. The availability of goods and services is essential for the benefit of the peoples at large, hence in maintaining those availabilities State is oblige to undertaking any policy and action to perpetuate the country's economic activities and sustainable development. This is a consequences of the implementation of article 33 (4) State Constitution 1945 "The National Economic is based economic democracy with the principles of togetherness, efficiency with justice, sustainability, environmental friendliness, independence and a balance economic progress and national unity" furthermore article 34 "(1) The poor and neglected children are maintained by state, (2)

The state develops social networking system for all citizens and to empower the weak incapable in accordance with human dignity, (3) The state is responsible for the provision of health care facilities and public service they are deserve, (4) further provisions concerning the implementation of this article shall be within the law" (Sriro 2010, Soule 2009). In the Indonesia positive laws, the State Constitution is the highest sources of laws. Hierarchy, the order of Indonesia positive laws:

1. The 1945 Constitution (Undang-Undang Dasar 1945);
2. Statutes (Undang-Undang)/Interim Emergency Laws (PERPU);
3. Government Regulations (Peraturan Pemerintah);
4. Presidential Regulations (Peraturan Presiden);
5. Regional Regulations (Peraturan Daerah).

Law must not conflict with any law higher than any own type in the hierarchy and law can amend or revoke any law that is lower than that is type in the hierarchy. The legal basis of Indonesia CSR stemmed from Investment Law (Law No. 25 of 2007), Limited Liability Law (Law No. 40 of 2007) and State Own Enterprises Law (Law No. 19 of 2003) complemented by Government Regulations, Presidential Regulations, Regional Regulations and Minister Decree.

There is strong contemporary interest in exploring the relationship between corporate social responsibility and environmental responsibility. Overlapping in implementing regulation sometime is inevitable. For example in the extent of ownership of the company, the companies such as Garuda Indonesia and PT Telkom, in nature they are public companies, most of the share posed by the government as a consequences those companies also fall under State Own Enterprises Law. In normative context there will be conflicting of interest, on one hand provision of CSR in the Limited Liability Company Law is limited to the company which performs in the field of natural resources and there is no obligation to undertake the CSR to others company on the other hand, the provision of CSR as states in the State Own Enterprises Law and follows by Minister Decree and Minister Regulation is clear and involving standard operational procedure, there will be no doubt to undertake corporate social responsibility.

Having establishment of the background of this article, the section of the article divided such as follows:

**Section I.** Examines the historical background and nature of the legal basis of CSR in Indonesia.

**Section II.** Introducing the Nature of CSR in the perspective of legal framework.

**Section III.** Legal framework of CSR in the perspective of Indonesian National Law applies the legal framework to the development of CSR in Indonesia and the interactive process associated with the legal construction, government policy and explores the

main sets of ideas and the theoretical framework. The last section of the article draws the conclusion and recommendation.

## **HISTORICAL BACKGROUND OF THE LEGAL FRAMEWORK OF CSR**

Since Indonesia entering the reform era (1998), House of Representative often proposed CSR as a compulsory item in the several laws and regulations which is related to economic, social and environment, as a result law and regulation of CSR exist in three laws, Investment Law (Law No. 25 of 2007) Law Limited Liability Company (Law No. 40 of 2007) and State Own Enterprises Law (Law No. 19 of 2003).

### ***CSR in Investment Law***

Prior 2007, Investment law in Indonesia consists of two laws that is Domestic Investment Law (Law No. of 1967) and Foreign Investment Law (Law No. of 1968), in 2007 Parliament and Government agreed to renewed Investment Law and become Investment Law (Law No. 25 of 2007). Foreign Invested Enterprises and Domestic Invested Enterprises are company which granted fiscal privileges such as import duty facility and proposal for Income Tax facility and non-fiscal privileges such as Number of Importers Produced, planning for using foreign workers and working visa from the government. The purposed of improvement is to attract foreign and domestic investors such as mentions in article 3 (2) states the need for investment to increase economic growth, employment, sustainable economic development, national competitiveness, technological capacity and public welfare.

The equal treatment to domestic and foreign investors is assurance, the rights granted to the investor states in the article 14 (a) Every investor is entitled to obtain certainty of rights, law and protection (b) open information concerning business sectors within which they are engage (c) right to services and (d) various of facilities in accordance with provisions of regulations of law. Instead of preferences that granted to investors also require to perform of obligations as states in the article 15 Every capital investor is required to "Adhere to principles of good corporate governance" Art 15(a), implement corporate social responsibility Art 15(b), make reports concerning capital investment activities and deliver them to Capital Investment Coordinating Board Art 15(c), respect cultural traditions of society in locality of capital investment business activities and Art 15(d), fulfill all provisions of regulations of law Art 15(e).

The law related to CSR as mentions in the article 15 (b) implement corporate social responsibility, non-compliance is lead to administrative sanctions, which include warnings or even the limitation, freezing or cancelling of investment activities as states in article 34 (1) these sanctions will be imposed by the institution with authority as

declared in Law article 34 (2). In a common sense CSR encompasses economic responsibility, legal responsibility, ethical responsibility and philanthropy responsibility, the implementation of responsibility is on voluntary basis. One among the reason of requirement to fulfill CSR to foreign investor and domestic investor followed by administrative sanction to the non-compliance is to perpetuate social life of the peoples and their environment from investment activities. Other reason is in certain conditions voluntary CSR is cannot suitable to the need and concern of other parties.

Moreover new Investment Law also allow foreign investors to obtain and hold land for longer than previously permitted, since then interaction with the native surround more intent and as a consequences environment responsibility should be taken into account and the burden emerged from those interactions become responsibility of investors and the peoples surround. The scope of stakeholders' role not only covers the social environment responsibility surround because the social life sometime impacted wider than the expectation.

#### *CSR in Law Limited Liability Company (Law No. 40 of 2007)*

In order to enhance the national economic development and providing a solid platform for business community in facing the developments of the international economic and also the science and technology, the government needed to renew the Law of Limited Liability Company. Definition of Limited Liability as referred in article 1(1) (Law No. 40 of 2007), states "In this Law a Limited Liability Company (hereinafter called a "Company") means a legal entity constitutes an alliance of capital, established in pursuant to a contract in order to carry business activities with an authorized capital which is divided into shares and which fulfills the requirement stipulated in this Act and its implementing regulations". Moreover corporation as the agents of economic welfare and function as limited liability companies are required to provide added values in the form of both financial returns for the shareholders and the benefit for the peoples and environmental preservations. The law related to CSR Corporate Environmental and Social Responsibility in Indonesia as states in article 74 of Law Number 40 2007 on Limited Liability Company establishes that's:

1. Companies doing business in the field of and/or in relation to natural resources must put into practice Environmental and Social Responsibility.
2. The Environmental and Social Responsibility contemplated in paragraph (1) constitutes an obligation of the Company which shall be budgeted for and calculated as a cost of the Company performance of which shall be with due attention to decency and fairness.

3. Company who do not put their obligation into practice as contemplated in paragraph (1) shall be liable to sanctions in accordance with the provisions of legislative Regulation.
4. Further provisions regarding Environmental and Social Responsibility shall stipulated by Government Regulation. In respect to the implementation of article 74 p 1, 2, Limited Liability Companies Act No. 40 of 2007, state that "A corporation in performing its obligations shall be completely comply in accordance with the purposes and objectives of social and environmental responsibility." Article (1), Environmental and Social Responsibility means "A Company's commitment to take part in sustainable economic development in order to improve the quality of life and environment, which would be benefit for the company itself, the local community and society in general."

#### ***CSR in State Own Enterprises Law (Law No. 19 of 2003)***

As implementation of the State Constitutions 1945, several rules and regulations regarding the CSR have been issued, for instance in Law Number 19/2003 regarding the establishment of the SOEs accordingly in article 2, "the SOEs must be active on exercising and delivering aid directed to small medium enterprise, cooperative and peoples. The aim of exercising and delivering financial aids is to improve social life of the peoples in general sense and to boost the capacity and capability of the small medium enterprises and cooperative in conducting their activities on their respective business field.

How the State Own Enterprises implement their CSR? Minister of the State Owned Enterprises of the Republic of Indonesia, issued the Minister Decree (Keputusan Menteri) Number Kep 236/MBU/2003, on that decree it is states "State Own Enterprises are oblige to carry out the partnerships and environment coaching, the Indonesian those program is PKBL (Pembinaan Kemitraan dan Bina Lingkungan)". Partnership development program is defined as improvement program for increasing the capability of Small Medium Enterprises in order to stronger and self-sufficient. Environmental Development Program defined as Empowerment program of the socials of the peoples through the profit of State Own Enterprises. Instead Minister Decree No 236/MBU/2003 through Minister Decree No. Per-05/2007 (Permen No. Per-05/2007), aim of the Minister Decree of 2007 to emphasizes State Own enterprises in performing their obligation, social duty awareness, accountability and corporate actions. The pin points of policy principal that can be concluded are as follow:

1. Profit allocation maximum 2% for the Partnership Development Program and Environmental Development Program,
2. Services Budget 6 % or subject to change,

3. Operational Cost : 100% administration. Loan and others revenue,
4. Business to Business synergy,
5. Environmental Development Program 30% for State Own Enterprises Environment Care and
6. Environmental Development aid Program for natures conservation.

Partnership development means that's every State Own Enterprises oblige to develop the partnerships particularly partnerships with Small Medium Enterprises, no matters the business field of each others are same or different aids given to the Small Medium Enterprises is purely in the spirit of charity and philanthropy. With no heed to the business field of each parties indicating the nexus between two enterprises merely as an ordinary business relation there are no overlapping in the ownerships at all. The objective of the partnership development will helping Small Medium Enterprises the capacity and capability of Small Medium Enterprises at large through capital aid, improving (management, marketing, producing skill) and etc. Partnership and Community Development Program (Program Kemitraan dan Bina Lingkungan - PKBL) as in which the costs incurred must be taken from the net profit of the company.

The implementation of the Ministry decree above were to emphasis the social responsibility obligation of the SOEs. In addition to the emphasizing of the obligation of the SOEs duty, the content of the decree also contain the standard of procedure of implementation of the social partnerships in order to coaching and delivering the financial aids program. Financial aspect was played major role on the implementation of the CSR in the scope of SOEs. The sources of the CSR fund should be taken from the net profit of company's last year activities it is mandatory as stated on the Decreed of Minister of Small Medium Enterprises. It means that the funds must be taken after the net profit and not before profit, it is contrary to Law Limited Liability, the implementation of the social environmental responsibility is submitted to the respective company which is also inclusive enacted of codes of conduct of the company because the share of State Own Enterprises not only pose by the government. The historical background of the Law Number 19 1960 of State Own Enterprises Law put the five different types of State Enterprises under one single regulation in order to facilitate the administration of state enterprises. The objective of the formation of state enterprises is varied. The state own company under the one statute article 1 of Law No. 19 1960 states "the state enterprises is any enterprise the capital of which is State property of belongs to the State's Treasury, except when otherwise state by the law" the capital is, an amount separated from the State's Treasury, not divided in share. State Own Enterprises is established by the Government Regulation.



## INTRODUCING THE NATURE OF CSR IN THE PERSPECTIVE OF LEGAL FRAMEWORK OF CSR

Sharing benefit of exploiting natural resources is becoming one of the strategic methods to accelerate the creation of public welfare. Commonly, the exploitation of natural resources involves many corporations, particularly multinational corporations (MNC) and leading company. Numerous concessions were granted to foreign investors in order to boost the capital inflow and transfer technology. The concessions also incorporated in many sector such as natural resources, plantation and transportation. In some countries contact between multinational and their home states were not always friendly, home states are aware of the potential threats of multinationals regarding the local economy, employment and safety policies. The establishment of foreign investors company results in a win-win profit for the shareholder (owners of the company) and home state. Exploration of natural resources sometime emerge of air pollution, water pollution or both and huge land hole and etc. Most of peoples particularly in the develop countries accept that the greenhouse gas emission (GHG) release into the atmosphere is still growing and emerging unpredictable changes to normal climate pattern, having regard to the environmental damage, all of stakeholders have to play a major role in global effort to put a brake on further climate changes. Carbon footprint it's the effective measurement, means that the quantification of how much damage to the environment by way of GHG emissions. The carbon footprints measurement is the amount of greenhouse gases in units of carbon dioxides, produced by human activities. In condition of river running dry, dropping lake and groundwater levels and species endangered because of contaminated water that indicating of water pollution. Alongside with the carbon footprints the water footprint helps to show the link that our daily consumption of goods and the problems of water depletion and pollution exist. There are three component of water footprint (Hoekstra 2009):

1. The green water footprint refers to consumption of green water resources (rainwaters storage in the soils as moisture),
2. The blue water footprint refers to consumption of blue water resources (surface and ground water) and
3. The grey water footprint refers to pollution and is defined as the volume of fresh water that is required to assimilate the pollutant load based on existing ambient water quality standards.

Many of company heavy consumers of water such as several mineral water producers (Aqua, Adest and local brand company), has conducted many water assessment. In the extent of government roles recently considering as government concern only, requirement to perform corporate social responsibility to company is

considered as devolution of social and environmental responsibility from the government to the companies. The notion of CSR is vary and specific a modern need and issues that not easy to pinned down precisely (Kerr et. al. 2009, 5), numerous of international organization incorporate legal values and scopes of CSR norm while producing standard. Without standard legal definition, implementation of CSR tend to avail code of conducts of the company, since then many companies in developing their own strategic and policy involved social responsibility issues. It is not easy indeed to balance the interest between the shareholder of the company and the stakeholder, interest of shareholder whichever comes first in order to return their investment as fast as possible, on the other way around home state in this regard considered as stakeholders has an obligation to preserve the interest of socials life of the peoples. In term of social responsibility activities of the company complication will emerge when the issues between pursuit of the profit on one hand and obligation to undertake social responsibility on the other hand. Corporate social responsibility that so-called CSR-as what Doreen McBarnet (McBarnet et al. 2009, 12) has written this:

CSR essentially involves a shift in the focus of corporate responsibility from profit maximization for shareholders within the obligation of law to responsibility to a broader range of stakeholders, including communal issues such as protection of environment, and accountability on ethical as well as legal obligations. It is shift from bottom line to triple bottom line, as it sometimes put, from profits to people, planet and profit indeed to profit principle to cite Shell International's social report.

In the absent of rule of law in the extent of implementation of social responsibility seven principles of New Delhi Declaration could be introduced as a basic law principles of social responsibility. The seven principles of New Delhi Declaration such as follow (UNISDR 2016):

1. Integrated, Sustainable Decision Making,
2. Stakeholder Engagement,
3. Transparency,
4. Consistent Best Practices,
5. Precautionary Principle,
6. Accountability and
7. Communities Investment.

## LEGAL FRAME WORK OF CSR IN THE PERSPECTIVE OF INDONESIAN NATIONAL LAW

An attempt was made to put the obligation of CSR in the three legal bases that is Law of Investment (Law No. 25 of 2007) Law of Limited Liability (Law No. 40 of 2007) and Law of State Enterprises (Law No. 19 of 2003). The Foreign/Domestic Invested Enterprises which performing their business in the field of exploration of natural resources always granted privilege from the State. The nexus between investor and State should be in the contractual basis (Kerr et. al. 2009), concession granted by the State not only to the investment companies, others company also entitle to get concession from the State. The theory of classical international law principles is priority gives to the home state to regulate of multinationals companies (Zerk 2006, 57), mean that every state has right to regulate MNC (multinational company) activities within their jurisdiction. The legal context of CSR in Indonesia constitute of mandatory aspect and voluntary aspect. Obligation to fulfill social responsibility followed by administrative sanction to non – compliance is sole power of provisions. The flexibility approach given by the Law in condition lack of further provision such as what mentions in the article 74 p 4 (Law No. 40 of 2007), provision regarding implementation of CSR is submitted to the respective company if there are no further provision follows, means that's company allowed to avail their own codes of conduct as a standard of procedure in performing social responsibility as long as the content of the code not against the law in this regard credibility of codes of conduct will reflecting performance of social responsibility of the company. Furthermore the international standard report of CSR performance of the company such as Global Reporting Initiative Generation 3 (Global Reporting Initiative 2011) and ISO 26000 are international standard that accommodated by most of the company in the world (Lambooy 2010, 261). Hence, in order to measure the CSR performance of the company particularly MNC whether GRI or ISO 26000 could be used as standard report.

In assessing the enforcement of rule and regulation certain criteria such as follows (Lo Fuller, the morality of Law 1964); law should be general, they should be promulgated, retroactive, understandable, not contradictory, not require beyond the ability, they should remain relatively constant, they should be a congruence between the laws as announced and their actual administration (Feinberg et al. 2004, 14), those criteria's should be taken into account. In respect to the Investment Law, with accordance to the provision of CSR to both foreign and domestic investors, enforcement of the law will implied by asking a question what is the measurement of corporate social responsibility activities, does the performance indicators of social responsibility of the investors will be accepted in compliance to the law, there's should be certain acceptable legal standard and norm in order to measure the performance of

social responsibility of the investors activities, voluntary approach such as company code of conduct existing can be avail as legal standard and norms. Having regard to perspective of relationships CSR with the law and public policy has been difficult to pin down whether prescriptively or descriptively (Ward and Smith, 2006, 14).

In respect to the administrative sanction to the non-compliance such as mentions in the Investment Law and Law Limited Liability Company provision to fulfill CSR is an absolute obligation. In absence of further provisions the company tend to do things easy, charity and philanthropy would be considered as social responsibilities, such as supporting social activities of the peoples surround the business location by giving certain amount of money and many other things therefore their activities would be considered as intention to avoid administrative sanction than social responsibilities at large.

Provision of CSR, such as mentions in State Own Enterprises Law is follows by Minister Decree and Minister Regulation. The procedure of implementation is very clear, unfortunately those provision only address to State Own Enterprises not to the private company. Basic requirements in performing CSR is financial performance of enterprises, that's financial past performance (previous year) should be in the positive balances position, means that State Own Enterprises in negative balance shouldn't performs CSR until they reach positive balance again. In the best practices those provision impacted the continuities of the program and emerging a question whether the enforcement will reflect the best practices or rather intend to stimulate to develop such best practices (Lambooy 2010, 261).

For the seeks of the MNC (multinationals corporation) company that fall under Investment Law, there is no further provision to undertake CSR besides of what was states in the Law. As transnational company, MNC should be fall also under International Law and as a consequences they will avail the International Treaties and International Agreement that is constitute of International Declaration as a results of International Summit in (Rio Brazil, Johannesburg South Africa and New Delhi India), as the basic principles in order to comply the regulation. In the meantime consensus in extent of CSR has been developed, the range of the consensus encompassing environmental and social issues that are applicable corporation generally, regardless of their size, sector and geographical location (Hennigfeld et. al. 2006).

In respect to Limited Liability Company Law, demand to fulfill environmental social responsibility limited to the company which performs in the field of natural resources but not to the company whose performs others activities hence in this regard the question will implied, in the extent of CSR obligation does the Limited Liability Company Law part of Investment Law. The conflicting norm between two provision will emerge uncertainty because demand to fulfill CSR as mentions in the Investment Law be understood as general provision to all kind of Foreign/Domestic Invested Enterprises,

in the other way round Limited Liability Company Law, limit to company which perform in the field of natural resources only. For the seeks, if there is no obligation to undertake of environmental social responsibility such as to the Limited Liabilities Company then will be rising question again does the company have a social responsibility. In regard to positioning approach, the companies can be seen as closed system functioning independently for the benefit of its owners or to the contrary as part of triangle of market, state and civil society (Hamers et al. 2005, 6). As part of the civil society, performance of the Company become strategic issue, output of the company as a result of business activities, commonly resulting of the outcomes of business in society which is including outcome in terms of business impact. Outcome of the company is an element of performance indicators at large since then regardless whether there is an obligation to undertake the CSR or not, performance of company would be measured from their social outcomes.

## CONCLUSION

Although legal basic of CSR in Indonesia is promulgated, but regulation to undertake the social responsibility as mentions in the three Laws such as Investment Law, Limited Liability Company Law and State Own Enterprises Law, rather to addresses to the specific company which is related to the type of the company. From the three legal basis mention above, only State Own Enterprises Law followed by the regulation regarding the implementation of undertaking corporate social responsibility. In terms of enforcement the double standard of measurement emerged from the overlapping of the provisions. Moreover in case of limited liability companies, if they are whether not performs in the field of natural resources and not registered as Foreign/Domestic Invested Enterprises, by the law there will be no obligation to undertaking corporate social responsibility at all.

The performance of social responsibility of the company is very importance, in respect to Minister State Own Enterprises Decree regarding the implementation of Corporate Social Responsibility; the company which allows performing of CSR is subject to the past performance of the State Own enterprises. The past performance of the company means is identified from the financial balances, for the State Own Enterprises whose indicate negative balance in the last years means those Enterprises not oblige to carry out the CSR. As a consequence if they are absence in performing of social responsibility, the performance of CSR of the company is impacted finally influence the performance of the company as a whole.

In line with the Law of Limited Liability Company as states in Article 74 p 4 the implementation of Environmental Responsibility is submitted to the respective company, the roles of the (OECD Guideline for Multinational Enterprises, the ten principles of

United Nation Global Compact, the ISO 26000 Guidance and Standard on Social Responsibility, the ILO Tri-Partite Declaration Principles Concerning Multinational Enterprises and Social Policy, and the United Nation Guiding Principles on Business and Human Rights), in implementing of CSR in Indonesia is very strategic and dominant because most of the MNC and leading company avail the basic principal above. 

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